CROATIA

Croatia’s economic freedom score is 61.4, making its economy the 86th freest in the 2019 Index. Its overall score has increased by 0.4 point, with a spike in fiscal health offsetting a precipitous drop in judicial effectiveness. Croatia is ranked 38th among 44 countries in the Europe region, and its overall score is below the regional average but above the world average.

In 2018, the government announced three main reform goals: improved economic competitiveness, an education system tied to labor market needs, and sustainable public finances. The debt-restructuring process of Agrokor, Croatia’s largest company, may add to the fiscal deficit. Significant remaining challenges include political volatility and a level of public-sector debt that makes government spending on health care and pensions fiscally unsustainable. There is a significant risk that the government will struggle to pass far-reaching reforms in other areas. Pervasive corruption undermines the rule of law, and protection of property rights is weak.

BACKGROUND: Croatia’s declaration of independence in 1991 contributed to the breakup of Yugoslavia along ethnic and religious lines. Croatia joined NATO in 2009 and the European Union in 2013. Prime Minister Andrej Plenkovic of the center-right HDZ party formed a coalition with the liberal Croatian People’s Party and several smaller parties in 2017. Political uncertainty hinders economic progress. Shipbuilding and tourism are major industries. A 2018 agreement to avoid bankruptcy positioned a Russian bank as the largest shareholder in Croatia’s largest private company, Agrokor. A weak export base, emigration, and the slow pace of privatization remain significant challenges. The government enacted legislation in 2018 to expedite construction of a liquid natural gas import terminal at Krk Island.

RELATIVE STRENGTHS:
Trade Freedom and Fiscal Health

HISTORICAL INDEX SCORE CHANGE (SINCE 1996):
+13.4

CONCERNS:
Government Spending and Government Integrity

POPULATION:
4.1 million

GDP (PPP):
$101.3 billion
2.8% growth in 2017
5-year compound annual growth 1.5%
$24,424 per capita

UNEMPLOYMENT:
11.2%

INFLATION (CPI):
1.1%

FDI INFLOW:
$2.1 billion

PUBLIC DEBT:
78.4% of GDP

2017 data unless otherwise noted. Data compiled as of September 2018.
Private property rights are well established, although conflicting claims and legal ambiguity can cloud some title cases. The government has simplified property registration by reducing real estate transfer taxes. Judicial independence is generally respected. Efforts to address case backlog and training concerns continue. According to Transparency International’s Corruption Perceptions Index, Croatia has made little progress in its anticorruption efforts.

The top personal income tax rate is 40 percent, and the top corporate tax rate has been cut to 18 percent. Other taxes include value-added and excise taxes. The overall tax burden equals 37.9 percent of total domestic income. Over the past three years, government spending has amounted to 47.1 percent of the country’s output (GDP), and budget deficits have averaged 1.2 percent of GDP. Public debt is equivalent to 78.4 percent of GDP.

Despite reforms to streamline the procedures for establishing a business, the overall regulatory environment remains burdensome and inefficient. A new labor law has been implemented in an attempt to make the labor market flexible and dynamic. Progress is slow on structural reforms to reduce subsidies and privatize state-owned enterprises, as required by the European Commission’s Excessive Deficit Procedure.

The combined value of exports and imports is equal to 100.4 percent of GDP. The average applied tariff rate is 2.0 percent. Croatia implements a number of EU-directed nontariff trade barriers including technical and product-specific regulations, subsidies, and quotas. Inbound foreign investment faces no screening mechanisms. Croatia’s financial markets are open to foreign investment, and over 90 percent of the banking sector is foreign-owned.